



**Testimony of John M. Robbins, CMB, Chairman**

**Mortgage Bankers Association**

**Washington, D.C.**

**before the**

**Subcommittee on Capital Markets, Insurance and  
Government Sponsored Enterprises**

**Committee on Financial Services**

**United States House of Representatives**

**Hearing on**

**“Legislative Proposals on GSE Reform”**

**March 12, 2007**

Chairman Kanjorski, Ranking Member Pryce and Members of the Subcommittee, my name is John M. Robbins, and I am Chairman of the Mortgage Bankers Association.<sup>1</sup> I also serve as Co-Head and Special Counsel to American Mortgage Network which is a subsidiary of Wachovia Bank. Thank you for the opportunity to testify before you today as you develop legislation to reform the nation's regulation of the Government Sponsored Enterprises (GSEs), including Fannie Mae and Freddie Mac as well as the Federal Home Loan Banks.

I have been in the mortgage lending business for more than 35 years and my companies have transacted business with both the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Association (Freddie Mac) on a daily, if not hourly, basis. Other companies in the Wachovia family of companies have long been members of the Federal Home Loan Bank System. In my official capacity at MBA, I have worked with representatives of lenders of all business models and sizes from across the nation to develop MBA's policies on GSE oversight reform.

Before I begin, please let me say, Mr. Chairman, that MBA particularly appreciates your commitment and leadership in moving GSE legislation forward and making it a priority of this Committee. MBA also appreciates the dedication of the Ranking Member and the other members of this Subcommittee in this Congress, and in the last one, who worked on this legislation and also made it a high priority of this Committee. This legislation is a first priority of MBA and the mortgage industry and MBA will do all it can to assist your work.

## **I. INTRODUCTION AND SUMMARY**

MBA strongly supports the vital role that Fannie Mae and Freddie Mac play in maintaining and improving liquidity and stability in the secondary mortgage market. MBA also strongly supports the vital role that the Federal Home Loan Bank System plays in providing liquidity to the primary mortgage market and supporting the demand for mortgages through advances by the FHLBanks to their members.

As you are well aware, all of these enterprises are exceedingly important to this nation's economy, the lending industry and families in America, whether they are homeowners

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: [www.mortgagebankers.org](http://www.mortgagebankers.org).

or renters. All of these enterprises are government sponsored, but in speaking of them today, I will use the term GSEs when I am referring to Fannie Mae and Freddie Mac and, when I refer to the Federal Home Loan Bank System, I will use the term FHLB System or FHLBanks.

It has been four years since accounting irregularities made weaknesses in the regulation of the GSEs clear to the general public. But for those who have worked closely on GSE regulatory issues, weaknesses in GSE oversight have been evident for a much longer time. Now that we know the many areas that need improvement, we are impatient to get the job of legislative improvement done and to get it done right. The GSEs and the FHLBanks also have indicated that they support reform of their oversight to put behind them a difficult and unhappy period in their distinguished and successful histories.

A key reason for the Great Depression and other economic catastrophes in the nation's history was a lack of liquidity for lenders across the nation. The establishment of the GSEs and the FHLBanks by Congress has proven to be a key element in rectifying this problem. Congress first chartered Fannie Mae, then the FHLBanks, and later Freddie Mac, to assure that liquidity in the housing financing market would be available to all areas and communities.

The GSEs' Charters seek to assure that the enterprises provide stability and ongoing assistance to the secondary market by increasing liquidity and improving the distribution of investment capital. The FHLBanks are cooperatively owned wholesale lending institutions that provide funds to their members at lower rates.

In order to carry out their secondary market functions, both GSEs receive significant explicit and implicit public advantages, including exemptions from certain state and local taxes, lines of credit with the U.S. Treasury and extraordinary borrowing advantages in the capital markets resulting from their public ties. The FHLBanks also benefit from a variety of statutory advantages.

As a result of their public missions and benefits, the GSEs provide the mechanism for lenders to fund mortgages through the GSEs' portfolios or their mortgage securities programs. They currently provide a secondary market and mortgage financing for mortgage lenders for an estimated \$3.5 trillion in loans, approximately 70 percent of the single family conforming loans in the nation, that is those that are below the current limit of \$417,000, and an estimated 45 percent of the nation's overall mortgage market. The combined portfolios of the enterprises are estimated to exceed \$2 trillion. Their combined outstanding debt is only slightly less than that of the United States Treasury.

While the GSEs' share of the market has declined in some areas recently, their market shares remain staggering. The scale of the Federal Home Loan Bank System lags the total of both of the GSEs but it is massive, too. The total consolidated obligations of the FHLBanks are just under \$1 trillion and their member institutions hold over \$600 billion in advances from the FHLBanks.

Because of their sheer size and the need to assure that the GSEs do not present a risk to the economy at large or to the mortgage finance system, in particular, the need for a world class financial regulator for these enterprises, with strong powers to assure that the GSEs remain safe and sound, is incontrovertible. Notwithstanding the hard work of the Office of Federal Housing Enterprise Oversight (OFHEO), it lacks some of the powers of other financial regulators. We need to be certain that legislation truly rectifies this problem going forward.

At the same time, the need to assure that the GSEs carry out their charter purposes and statutory responsibilities and do not stray beyond them is equally incontrovertible. Today's mortgage market is highly competitive and comprised of thousands of largely private industry firms of all shapes and sizes.

Firms in the primary mortgage market make loans to borrowers. The GSEs and other investors operating in the secondary market purchase loans from the primary market and thereby provide a ready source of funds so lenders can lend to consumers. The new GSE regulator must assure that the GSEs are carrying out their secondary market functions and assisting, but not harming the work of, the primary market. Although the Department of Housing and Urban Development (HUD) has worked hard at mission regulation of the GSEs, it has had even fewer resources and less direction than OFHEO to carry out its functions.

While the private securitization market has grown rapidly, the GSEs still are key participants in the mortgage market. If properly regulated and harnessed, the GSEs' power, fueled by their public advantages, can do all that needs to be done to respond appropriately to the primary market, so the primary market can provide families the credit that they need. If not effectively regulated, the GSEs can use that same power to unfairly distort the market by forcing primary market players out and taking the business for themselves.

The particular structures of Fannie Mae and Freddie Mac can be useful but also can create clear conflicts. The GSEs combine the advantages of government sponsorship with the functional organizations of shareholder-owned corporations. This structure, without effective, independent oversight of the GSEs' activities, invites conflict between the GSEs' public purpose goals and their corporate goals of maximizing returns to their shareholders.

For all of these reasons, MBA believes that regulation of the GSEs must be carried out by a strong, independent and well-funded entity with the resources and expertise to evaluate the GSEs' performance, both as financial institutions and as public purpose entities.

In this testimony, MBA will describe the primary and secondary markets and provide data on their scope. MBA will then outline our specific views to improve mission

regulation as well as safety and soundness regulation of the GSEs and the Federal Home Loan Bank System. Some of the key points include:

- Respecting charter mission regulation of the GSEs, the regulator should be empowered to ensure that both ongoing and new activities are consistent with the GSEs' secondary market purposes and applicable law and that the GSEs do not enter the primary market themselves. MBA's longstanding view is that Congress should ensure that the regulator understands the distinction between the primary and secondary mortgage markets. Legislation must provide the regulator authority to review all GSE activities to ensure they are consistent with these requirements and to effectively review all new undertakings to assure that they are in the public interest, are authorized, are safe and sound and do not distort the competitive landscape of the primary mortgage market.
- MBA believes the affordable housing goals should be maintained but refocused on the housing needs of lower-income borrowers. Direction should be given so that the goals are high enough to cause the GSEs to stretch their reach into underserved markets, but realistic enough so the goals do not cause market distortions. Since the goals should facilitate liquidity, the regulator should be given discretion to determine whether the GSEs should be allowed goals credit for particular types of mortgage purchases such as senior tranches of mortgage-backed securities (MBS).
- MBA believes that if an Affordable Housing Fund is established, it must be designed so that it is not ultimately a tax on consumers or lenders. The GSEs' regulator should be empowered to assure the proper use and administration of funds. An advisory board of industry practitioners should be established to assure that funds are spent appropriately.
- MBA does not support the proposal to expand the definition of high-cost areas for purposes of the conforming loan limits. MBA does not believe "jumbo loan" borrowers need GSE funding. MBA also is concerned that such an expansion may make it more difficult for the GSEs to meet their affordable housing goals.
- MBA supports efforts to empower the regulator, on par with modern U.S. bank regulators, to carry out every aspect of sound regulation. MBA believes that the regulator should have flexibility to set and adjust capital requirements. It is important that the regulator be empowered to intervene in the event of financial distress.
- MBA does not support embedding limits on the GSEs' portfolios in statute, but instead supports conferring sufficient flexibility on the regulator to act to the extent necessary. MBA's approach would permit the regulator to ensure that the GSEs' actions do not jeopardize the system without impairing liquidity in the mortgage market.

- MBA also opposes ending the GSEs' exemption from Securities Exchange Commission (SEC) registration for MBS. MBS registration could hinder the to-be-announced (TBA) MBS market.
- MBA supports establishment of a single regulator to oversee Fannie Mae, Freddie Mac and the Federal Home Loan Bank System. MBA strongly believes, however, that the new regulatory structure must reflect the fact that the FHLBank System is fundamentally different from Fannie Mae and Freddie Mac and provide a separate division for FHLB regulation. Any new law should also expressly authorize securitization of mortgages by the FHLBanks and continuation of their Affordable Housing Program (AHP). Both of these actions will benefit consumers.

Together the secondary and primary mortgage markets have offered the needed financing to provide homeownership and affordable rental opportunities across the nation, which has been a driving force in establishing communities, creating financial stability and wealth for consumers and fueling the overall economy. Improved regulation of the GSEs, including the Federal Home Loan Bank System, if properly done, will help assure the vitality and the robust, competitive nature of both the primary and secondary mortgage markets for years to come.

## **II. THE PRIMARY AND SECONDARY MARKETS**

### **A. America Has Two Residential Mortgage Markets**

America's mortgage market is divided into two components. One is the primary market, the other is the secondary market. In the primary market, consumers and apartment owners consult retail lenders and mortgage brokers to learn about the types of mortgage loans available, decide which loans meet their needs, apply for and then ultimately enter into mortgage loans. The lender or mortgage broker takes and processes loan applications and obtains supporting information, such as employment and income information, property appraisals and credit histories. If approved or underwritten by a lender, based on the information developed, the lender agrees to make a loan to the consumer or apartment owner, funds it, and closes the loan. This process, beginning with the borrower's first interest in a loan through and including funding and closing of the borrower's loan, is called loan origination. Loan origination and its related activities are the work of the primary market. Notably, the primary market functions with an enormous array of originators, private companies that are extremely competitive.

The other market, the secondary market, is quite different from the primary market. One very significant difference is that the secondary market does not involve mortgage consumers or apartment owners, only mortgage purchasers or investors and mortgage lenders. There is no loan origination in the secondary market. The secondary market is where investors buy and sell loans that are originated in the primary market.

Both markets are necessary. The reasons we need the primary market are plain; consumers and apartment owners need mortgage financing and originators in the primary market are the loan sources that borrowers work with to get it.

The need for the secondary market is just as important though not as obvious. Lenders use cash to originate loans, and they often need to sell closed loans to replenish their cash so they can make more loans. The greater a lender's ability to sell loans, the greater the lender's ability to originate them. At the same time, the secondary market functions well because it is liquid; institutional investors can readily buy and sell loans.

The secondary market includes private and public investors and government sponsored enterprises including the GSEs and wholly owned government corporations such as the Government National Mortgage Association (Ginnie Mae). Increased competition in the secondary market has made the pricing of primary market mortgages more competitive, resulting in lower costs to borrowers.

The GSEs have two principal businesses. Both Fannie Mae and Freddie Mac buy loans and securities for their own portfolios. They also sell their guarantee of repayment for mortgage backed securities. The GSEs securitize loans by bundling or pooling loans together and using the loans as collateral to back mortgage-backed securities (MBS). The GSEs sell the MBS to investors. As consumers across America make payments on their mortgages, those payments pass through to these investors. In exchange for the fee that lenders pay, Fannie Mae and Freddie Mac guarantee to MBS investors that the investors will be paid, even if consumers default on their loans.

MBS are a means of participating in the mortgage market through a liquid investment. From a cash flow standpoint, investing in MBS is roughly equivalent to investing in the aggregate of mortgage loans directly. But the MBS investor buys a share in a pool of loans, and does not buy interests in the loans directly. Investment in MBS allows investors to diversify their risks across a pool of loans so that any individual problem loan will have less impact on the MBS investor.

While there is and always has been an interface between the primary and secondary markets – lenders after all sell their loans to investors and must meet their standards – the statute and the regulator must assure that both markets can continue to operate effectively in their spheres.

## **B. Market Data and Information – Primary and Secondary Mortgage Markets**

The most recent data on mortgage loans made by lenders in 2004 and 2005 provided under the Home Mortgage Disclosure Act (HMDA) demonstrate the greatest and widest availability of mortgage finance in our nation's history. The data show that borrowers in virtually every area of the nation, of every race and ethnicity, and at every income level receive an array of credit opportunities.

Homeownership is near its highest level in history. As a result, Americans are building tremendous wealth. According to the Federal Reserve's Flow of Funds data, the value

of residential real estate assets owned by households has increased from \$10.3 trillion in 1999 to \$20.4 trillion as of the third quarter of 2006, and aggregate homeowners' equity now exceeds \$10 trillion. According to the Fed's 2004 Survey of Consumer Finances, the median net worth for homeowners was \$184,000. For renters, it was \$4,000. Clearly, many homeowners have been successful in accumulating wealth, both by steadily building up equity through their monthly payments, and through the impressive rate of home price appreciation we have seen in recent years.

More than a third of homeowners, approximately 34 percent, own their homes free and clear. Of the 66 percent of the remaining homeowners, 75 percent have fixed rate mortgages and only 25 percent have adjustable rate mortgages (ARMs). Many of the borrowers with adjustable rate loans have jumbo loans,<sup>2</sup> indicating that they are wealthier.

There were approximately 15 million mortgage originations in 2005, based on HMDA data, that were worth a total of \$2.8 trillion. Approximately \$10 trillion in residential mortgage loans were outstanding at the end of 2006. This enormous amount reflects an increase from \$5.1 trillion at the end of 2000, and \$2.6 trillion outstanding in 1990. In 2006, there were \$33 billion in multifamily property loan originations.

The confluence of several factors has contributed to the growth in credit opportunities for mortgage borrowers over the last 15 years. These factors include innovations in the mortgage market, resulting in the range of mortgage products available today including fixed-rate products and adjustable rate products as well as the "nontraditional."<sup>3</sup> They also include increased competition from an unparalleled number of loan originators including mortgage companies, banks, credit unions and mortgage brokers.

8,853 lenders reported under HMDA last year.<sup>4</sup> These lenders employ a half million workers nationwide to meet borrowers' credit needs. An estimated 2670 lenders originated multifamily loans.

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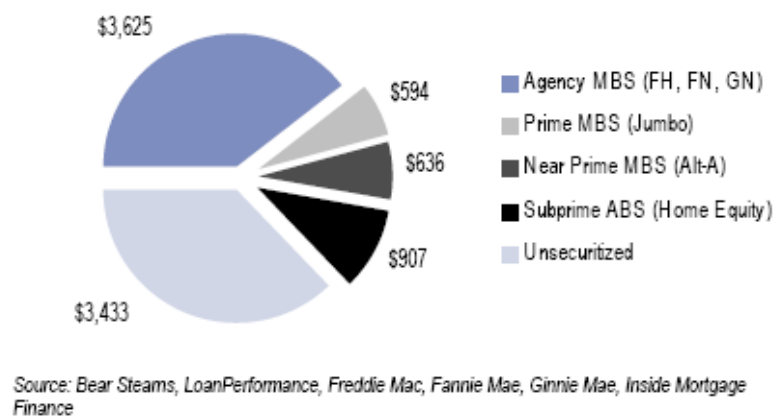
<sup>2</sup> Jumbo loans are loans that exceed the conforming loan limit, currently \$417,000 for single family properties.

<sup>3</sup> Under the Federal Regulators' Nontraditional Guidance, nontraditional products include mortgages that may involve the deferral of principal and/or interest including interest only and payment option mortgages. Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58,609 (Oct. 4, 2006).

<sup>4</sup> Banks that are exempt from HMDA reporting and Regulation C include institutions with less than \$35 million in assets, are not in the home lending business or have offices exclusively in rural (nonmetropolitan) areas. Mortgage companies are required to report unless they extend less than 100 purchase or refinance loans a year or do not operate in at least one metropolitan area.



The components of the secondary market for mortgages are illustrated in the following chart:



The secondary market is made up of the following.

**Fannie Mae and Freddie Mac** currently guarantee MBS valued at approximately \$3 trillion. Fannie Mae and Freddie Mac can only buy and securitize residential loans that meet charter act eligibility standards as to loan size and loan-to-value ratio. There are virtually no restrictions on the multifamily loans that the GSE may purchase. Fannie Mae and Freddie Mac maintain a very large presence in the secondary market. As indicated, they purchase or securitize approximately 70 percent of the single family conforming mortgage loans in the United States. Their share of the market for multifamily loans in 2005 was 27 percent.

**Private-label MBS issuers**, which are non-GSE securitizers, such as lenders and dealers, issued more than half of the mortgage-backed securities in 2005 and 2006, outpacing the GSEs. Private label issuers generally do not guarantee their MBS but publicly offered securities are subject to rating and senior investors receive a variety of other sources of credit enhancement. The loans backing private label MBS are typically ineligible for GSE purchase. Loans that are too big for Fannie Mae and Freddie Mac to purchase (jumbo loans), as well as subprime, low documentation, and other non-conforming mortgages are securitized by these issuers. In 2006, over \$1.1 trillion in private-label MBS was issued, including jumbo, nonprime, Alt A, and other nonconforming mortgage products.

**Government National Mortgage Association (Ginnie Mae)** securitizes FHA-insured, Rural Housing Service (RHS) and Department of Veterans Affairs (VA) guaranteed residential and multifamily mortgage loans. Currently the outstanding balance of these securities is approximately \$412 billion.

**Federal Home Loan Banks** hold government loans and conventional, conforming residential loans in the approximate amount of \$98 billion. Like Fannie Mae and

Freddie Mac, the FHLBanks have portfolios and they invest in Ginnie Mae, GSE and non-agency MBS.

**Whole loan portfolio investors**, including thrifts, banks, pension funds, and insurance companies, hold unsecuritized loans, both residential and nonresidential, for their own portfolios. The whole loan market is approximately \$3.4 trillion today.

### **III. IMPROVEMENT OF THE GSEs' MISSION AND SAFETY AND SOUNDNESS REGULATION IS NECESSARY**

MBA regards the imperative of assuring the safety and soundness of the GSEs, on the one hand, and assuring that the GSEs carry out their public missions, on the other, as necessary prerequisites of each other. If the GSEs are not safe and sound, they cannot carry out their missions. If they fail in carrying out or go beyond their missions, no matter how safe and sound they might be, they will not perform their functions and distort the competitive landscape of the mortgage market.

MBA, therefore, believes that the essential components of a new regulatory paradigm are first and foremost the establishment of a new single regulator, independent from the appropriations process. The regulator then must be given strong powers to address current weaknesses in GSE regulation to protect the safety and soundness of the enterprises and to assure that the GSEs fully achieve but do not go beyond their public purposes and applicable law. The regulator must also be given the flexibility to move quickly and nimbly to carry out these purposes as described in this testimony.

The regulator must have the authority to assure that the GSEs' purposes are performed through new program review authority, general regulatory authority, authority to establish and enforce the housing goals, fair lending and reporting requirements as well as all other mission related authorities.

The GSE regulator should have the same enforcement tools the banking agencies have for all of its functions. Among these is cease and desist authority. Cease and desist authority is one of the most fundamental, effective, flexible, and important tools a financial regulator can have. Regulators can narrowly tailor cease and desist orders to resolve a particular problem, without otherwise limiting or interfering with the institution's operations. Assuring flexibility in cease and desist orders makes them effective.

### **IV. THE GSEs' MISSION REGULATION IS ESSENTIAL TO THE MORTGAGE MARKETS AND MUST BE IMPROVED**

The GSEs' Charters specify the purposes of the enterprises including: (1) providing stability in the secondary market for residential mortgages; (2) responding appropriately to the private capital market; (3) providing ongoing assistance to the secondary market for mortgages (including activities relating to mortgages on housing for low and moderate income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments

and improving the distribution of investment capital available for residential financing; and (4) promoting access to mortgage credit throughout the nation including by increasing liquidity and improving the distribution of investment capital available for residential financing.<sup>5</sup>

The Charters and current law, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA), detail the GSEs' authorities and establish prohibitions against certain activities including the direct origination of mortgage loans.<sup>6</sup> FHEFSSA also establishes the GSE affordable housing goals, fair lending and reporting obligations of the GSEs.

MBA strongly believes that any new regulator must have sufficient authorities and powers to assure that the GSEs carry out their purposes and perform their statutory functions including enforcement authorities. The following describes MBA's views on certain of the GSEs' functions as well as its views concerning other mission related matters including the possible prohibition of the GSEs' purchases of senior tranches of MBS secured by hybrid ARM or other loans, establishment of an affordable housing fund and expansion of the conforming loan limits for high-cost areas.

#### **A. Assuring Charter Compliance for the GSEs' Ongoing Activities and Review of New Programs**

An essential part of regulating Fannie Mae and Freddie Mac is monitoring the GSEs' adherence to their Charters and assuring that the GSEs carry out their secondary market functions. HUD is charged with that task today, but like OFHEO, it lacks some of the most basic tools to do the job.

HUD is empowered to exercise "general regulatory power" to ensure that FHEFSSA and the purposes of the GSEs' charters are accomplished.<sup>7</sup> HUD reviews "new programs" of the GSEs.<sup>8</sup> However, the specific provisions regarding new program review are constrained by a rigid time frame and unclear statutory review standards. HUD has the same amount of time to review all new programs – the same amount of time, no matter how simple or how groundbreaking the program might be.

The current definition of a "new program" effectively limits the programs subject to review and the standard of review does not allow HUD to reject a program unless it can demonstrate that it is unauthorized under broad authorities or the program is "not in the

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<sup>5</sup> 12 USC 1716, 12 USC 1451 note. The Fannie Mae Charter includes a fifth purpose concerning managing and liquidating federally owned mortgage portfolios in an orderly manner.

<sup>6</sup> Section 304(a)(2)(B) of the Fannie Mae Charter, 12 U.S.C. 1716;; Section 305(a)(5) of the Freddie Mac Charter, 12 U.S.C. 1451.

<sup>7</sup> Sec. 1321 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA), 12 USC 4541.

<sup>8</sup> Sec.1322 of FHEFSSA, 12 USC 4542.

public interest.” The current law also does not allow HUD to reject a program application on safety and soundness grounds. It is not clear to what extent the regulator may review and order a stop to ongoing activities that are outside of the GSEs’ Charter. To carry out all these functions, HUD’s budget has been woefully inadequate. MBA supports legislation to address all of these matters.

Congress chartered Fannie Mae and Freddie Mac and conferred substantial public benefits on them including exemption from certain state and local taxes and a line of credit with the Treasury to do their jobs. Most other companies, banks, thrifts, and other lenders are chartered or created by a federal or state authority, not by Congress and do not enjoy these same advantages. Because of their public benefits and ties, the GSEs are able to undercut the prices of others in the marketplace.

For all of these reasons, the GSEs are subject to Congressional oversight. For the same reasons, they should be subject to strong regulatory review with clear guidance from Congress to assure that they perform their missions and do not deviate from them at the cost of the private market.

Notably, the GSEs at times have encroached upon the private market, to the detriment of competitors and competition. In recent years HUD, for example, required Fannie Mae to cease its real estate owned (REO) management and disposition activities because those activities are beyond the GSE’s charter. Those activities interfered with private market competitors who offer the same services.

MBA’s longstanding view is that Congress should ensure that the regulator understands the distinction between the primary and secondary mortgage markets. The regulator should be given clear direction to review all GSE programs, products and activities to assure they are consistent with the GSEs’ charters and applicable law. The regulator must be empowered to effectively review all new undertakings to assure that they are in the public interest, are authorized, are safe and sound and do not distort the competitive landscape of the primary mortgage market.

Giving clear direction to review the GSEs’ activities and establishing standards for such review regarding existing and new programs would provide more than mere clarity. It would go a long way to assuring competition in the future in both the primary and secondary markets.

We would add, however, that MBA supports the ability of the GSEs to innovate to carry out their charter purposes. Such innovation is vital to the primary mortgage market. The new regulatory requirements must recognize this point and assure that the GSEs are able to make technological improvements within their sphere in a timely manner.

Finally, there are a number of ways to assure that the GSEs’ purposes are carried out. Whatever means is chosen, the accompanying legislative history should make clear that Congress intends that these authorities indeed be fully carried out and that no negative

inference should be gleaned from Congress's decision not to pursue any previous formulation of these authorities in earlier versions of this legislation.

## **B. Affordable Housing Goals**

Fannie Mae and Freddie Mac must also meet affordable housing goals that Congress mandated in 1992. In establishing these goals, Congress did not expand or alter the GSEs' secondary market role. Rather, Congress clarified the GSEs' obligations to carry out their purposes of serving the primary market by purchasing, in the secondary market, their fair share of mortgage loans made to finance homes including those for low-income families and in underserved areas.

Fannie Mae's and Freddie Mac's affordable housing goals are a key part of the GSEs' role in the secondary mortgage market. MBA wholly supports the GSEs' efforts to help finance affordable housing. MBA believes the goals should be high enough to cause the GSEs to stretch their reach into underserved markets, but that the goals should be reasonable, to avoid market distortions or other adverse unintended consequences. Congress should not give the regulator authority to set an unlimited number of goals and subgoals.

MBA believes that Congress should retain the existing housing goals, but should amend them to provide greater focus on the housing needs of lower income households. MBA also believes that it is important to focus on what activities count toward the goals and support, for example, the view that loans that lenders have to repurchase from the GSEs should be subtracted from the goals-eligible loans at the time of the buyback.

## **C. Goals Credit for GSE Purchases of Senior Tranches of MBS Secured By Hybrid ARMs**

MBA is aware of recent testimony by consumer advocacy organizations before the Senate Banking Committee concerning nonprime lending, to the effect that the GSEs' purchases of senior tranches of MBS securitized by nonprime hybrid ARMs – specifically 2-28 and 3-27s – should not count toward the goals. These organizations assert that these products are harmful to nonprime borrowers because payments increase after their initial fixed payment periods of two to three years. MBA strongly disagrees. MBA has consistently pointed out that these products are useful affordability options for mortgage borrowers including those in the nonprime mortgage market.

Under current law, HUD establishes guidelines to measure the extent of compliance with the goals which may assign full credit, partial credit or no credit toward achievement of the goals to different categories of mortgage purchases.<sup>9</sup> Under a new law, the Director should exercise this authority considering the value of these and other products to homeownership, as well the extent to which purchases of senior tranches of these and other securities add to liquidity and otherwise meet the objectives of the

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<sup>9</sup> Sec. 1336 of FHEFSSA, 12 USC 4566

goals.

#### **D. Affordable Housing Fund**

Some have suggested that, in addition to retaining the affordable housing goals, Congress should require the GSEs to contribute to a fund to assist lower income families in obtaining affordable housing. While several proposals have been offered on how to calculate the contribution, MBA has concluded that any contribution should be calculated as a percentage of outstanding GSE debt. This approach would help avoid making the fund a tax on consumers or lenders. It would also tie the contribution to a benefit of government sponsorship, the GSEs' lower capital costs. Notably, the same amount of contribution can be required under this calculation method as any other method.

To assure that the funds actually go toward meeting the affordable housing needs for which they are intended, the GSEs' regulator should have authority to determine by regulation how the funds are used and to monitor their administration. An advisory board of industry practitioners should be established assure that funds are spent appropriately. If the funds are distributed by a formula to state or local agencies to administer, MBA recommends that a process similar to that used for HOME<sup>10</sup> funds be employed so that both cities and states receive an allocation and have the ability to target the funds to areas of greatest need.

#### **E. Expansion of High-Cost Areas and Ceiling Increases for GSE Eligible Loans**

In the last Congress, Representative Gary Miller (R-CA) introduced an amendment to expand the number of high-cost areas for purposes of the GSE conforming loan limits beyond those currently in place. Currently, the nationwide conforming loan limit for loans eligible for GSE purchase for securitization or for their portfolios is \$417,000 for a single family home. Under the GSEs' Charters, this limitation may be increased by up to 50 percent to \$625,500 for properties located in Alaska, Hawaii, Guam and the Virgin Islands.

To respond to the increased housing costs of recent years, the Miller Amendment would have allowed access to GSE financing for mortgages in additional high-cost "areas." The term "areas" was not defined in the legislation but many assumed it to mean Metropolitan Statistical Areas (MSAs).

MBA does not support this amendment. We respectfully ask the Committee to consider the following points.

If such an expansion were imposed today, there would be few new high-cost areas under an MSA approach based on higher housing costs. Today, if MSAs were used to define new high-cost areas only twelve MSAs would likely be added as new high-cost

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<sup>10</sup> HOME Investment Partnerships Act, 42 USC 12701 note.

areas.<sup>11</sup> All of those MSAs are located in California, the New York metropolitan area and the Washington, D.C. metropolitan area.<sup>12</sup>

While MBA opposes the addition of new high cost states as unwarranted, use of ZIP codes, census tracts or a county-based system would present operational difficulties and increase loan costs to borrowers.

Ordinary arithmetic suggests that if the GSEs are able to purchase additional mortgages, it will be more difficult for them to satisfy percentage based affordable housing goals

In 2006, the private mortgage market funded over \$500 billion in jumbo mortgages, ineligible for GSE purchase, for borrowers in all sectors of the market, prime and nonprime, in all states, utilizing fixed-rate and adjustable-rate mortgages. MBA is unaware that any jumbo borrowers faced any obstacles to obtaining this financing.

The difference in the mortgage rate between a conventional, conforming mortgage and jumbo mortgage ordinarily ranges between one-eighth of a percent and one-quarter of a percent for a fixed-rate mortgage, or less. There is frequently no difference in the mortgage interest rate for an adjustable-rate mortgage.

The percentage of borrowers qualified for a mortgage above the GSE ceiling limit of \$417,000 comprises a very small percentage of the population. In order for a borrower to qualify for a mortgage of \$625,500, the borrower would ordinarily need to earn an income of at least \$170,000.

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<sup>11</sup> We are using data furnished by the National Association of Realtors, one of the few sources of relatively current housing prices. The data is current through September 2006.

<sup>12</sup> The proposal previously introduced would have allowed the high-cost area limits to be above the GSE ceiling limits by the lower of the median housing cost level in the "area" or 150 percent of the GSE ceiling limit. That maximum, based on this year's GSE ceiling limit, would be \$625,500 for a single-family home. Only one MSA in the country has a median housing cost at or above that amount and most of the new high-cost areas would be eligible for a new ceiling vastly lower than the 150 percent high-cost maximum.

If the MSA approach were rejected, an alternative would be the current approach of identifying states (Hawaii and Alaska) or similar types of jurisdictions (Guam and the Virgin Islands). According to the most recent statistics published by the Federal Housing Finance Board for purchase prices by state, however, only three jurisdictions have median purchase prices above the GSE loan ceiling: Hawaii (\$454,200), the District of Columbia (\$504,000) and California (\$516,700). It is not evident that simply adding these jurisdictions as high-cost areas would meet the goals of the advocates of the proposal.

## **V. SAFETY AND SOUNDNESS OF THE GSES IS IMPORTANT TO THE MORTGAGE MARKETS**

The GSEs must act in a safe and sound manner to perform their secondary market functions, including meeting their affordable housing goals.

America has seen growth in the value of its housing stock, and this is a source of wealth for the more than two-thirds of American families who now own homes. As the homeownership rate and our population have grown, the need for responsive housing finance has increased accordingly. As technology has advanced and as refinancing has become easier, the equity Americans have in their homes has become more liquid. Homeowners' ability to tap their equity has been a major engine for economic growth.

Our housing finance system, made up of both GSEs and private companies, requires access to liquid funds day in and day out from both American and international capital sources. The housing GSEs are major links between the capital market and the housing market.

Regulating the safety and soundness of two firms as big and as complex as Fannie Mae and Freddie Mac is extremely challenging. For this reason, MBA believes the safety and soundness regulator should have all the tools necessary for the task. The regulator needs general regulatory authority, which OFHEO currently lacks. The regulator should have enforcement authority on par with that of the banking agencies.

Further, MBA believes the GSE regulator's budget should be funded through assessments on the regulated entities outside the appropriations process, as bank regulators are funded. An insufficient budget, pressured by the constraints of appropriations, as well as regulatory weaknesses have been a serious impediment to Fannie Mae's and Freddie Mac's regulators over the years.

### **A. Capital Regulation**

It is important that Fannie Mae and Freddie Mac maintain capital levels that support liquidity for the residential mortgage markets and that are also consistent with safety and soundness, stability for the overall market, and minimum exposure to the American taxpayer. Some have proposed that the regulator's capital authority should permit the regulator to require capital increases only in a narrow set of circumstances. MBA does not share that approach. MBA believes the regulator should have flexible authority to set appropriate capital standards.

Today, Freddie Mac's and Fannie Mae's capital surcharge is required through OFHEO's cease and desist authority, not its capital authority. OFHEO's cease and desist authority is flexible and can address many problems, not just capital deficiencies. If the regulator's capital authority is limited, it is possible that some might construe the capital



authority as limiting the regulator's cease and desist authority. It is important that Congress be careful not to inadvertently limit the regulator's cease and desist authority.

## **B. Receivership**

Congress has debated whether to include provisions that would permit a regulator to appoint a receiver if either Fannie Mae or Freddie Mac were to become financially distressed. MBA's view is that in the unlikely event of distress at either company, it is important to maintain the operations of mortgage finance markets. MBA believes this should be the fundamental principle behind any receivership provisions.

MBA does not believe the regulator should appoint a receiver or conservator lightly. Rather, the regulator should only be able to appoint a conservator or receiver when there is a serious capital deficiency, a serious threat to liquidity, or a real possibility of market disruption.

When a regulator does need to intervene, it should be able to operate the enterprise to restore it to health if that would best protect the housing markets. If necessary, the regulator should be able to maintain the operations of the mortgage securitization business, which is critical to the markets, while winding down the portfolio operation in an orderly manner. Because it may be necessary for a GSE in receivership to issue debt to ensure an orderly wind-down of the portfolio business, the receiver should of course have the authority to cause the GSE to issue debt to ensure that orderliness.

To ensure certainty in the markets today, before there is a problem, Congress should specify a priority of claims in the event either Fannie Mae or Freddie Mac is in receivership. Congress should specify that holders of MBS that the GSE had issued have a prior claim to the mortgages backing the MBS, as well as to the flow of revenue the GSE continues to receive as guarantee fees. That guarantee fee revenue would be necessary for the securitization business to continue. The securitization business is critical to market function, and Congress should ensure its continuation even if Fannie Mae or Freddie Mac were in receivership. This would help maintain the operations of the mortgage finance markets, which should be the underlying policy for any Congressional action in this area.

Only Congress, not the regulator, should be able to rescind a GSE's charter.

## **C. Portfolio Restrictions**

During discussions of regulatory improvements, it has been suggested that Congress should place strict limits on the size of Fannie Mae's and Freddie Mac's portfolios of mortgage loans and MBS due to risks arising from the portfolios.

While MBA is supportive of efforts empower the regulator to protect against financial risks presented by the GSEs, MBA does not believe that a Congressionally mandated dollar cap or limit on the GSEs' portfolios would be the best method of protecting

against such risks. The mortgage and financial markets fluctuate and evolve. In 2006, for example, the market shrank and the GSEs' portfolios shrank in part due to changing market conditions, and in response to increased regulatory capital requirements. A rigid dollar cap on the GSEs' portfolios would not have adjusted to these changed circumstances.

The GSEs' portfolios can provide liquidity and stability in times of market turmoil. For example, in 1998 when many financial markets were in turmoil due to the Russian debt crisis combined with the collapse of Long Term Capital Management, the GSEs' ability to rapidly expand their portfolios helped maintain stability in the mortgage market. A hard-wired portfolio limitation could interfere with this important function.

The portfolios also help the GSEs meet their affordable housing goals. Special loan structures enable many lower income families to purchase homes. And, there are unique characteristics of single-family reverse mortgages for the elderly making them difficult to securitize. Both Fannie Mae and Freddie Mac purchase a significant number of single-family and multifamily loans that are not easily securitized for their portfolios and these purchases make a critical contribution to the GSEs' ability to meet their goals. A rigid portfolio limitation could interfere with this important source of financing for affordable homes for lower income Americans. Finally, by financing their portfolios, the GSEs also have attracted significant foreign capital to the American mortgage markets, allowing the U.S. housing market to grow. This function should be preserved.

While the MBA does not support the establishment of arbitrary limits on the GSEs' portfolios, this does not mean that it supports unchecked portfolio growth. The regulator should be authorized to assess the risks in each GSE's portfolio and the degree to which the portfolio supports the GSE's secondary market and affordable housing mission. Based on this analysis, the regulator should be empowered to design appropriate means for limiting the risks of the portfolios considering current financing needs.

#### **D. GSE Exemption from SEC Registration**

The GSEs' Charters contain specific exemptions from Securities and Exchange Commission (SEC) registration. In response to a considerable degree of pressure, the GSEs agreed in July 2002 to register one class of their common stock under Section 12 (g)<sup>13</sup> of the Securities and Exchange Act of 1934 (the '34 Act or the Exchange Act). Pursuant to the Exchange Act's reporting requirements, the GSEs agreed to file annual, quarterly and current reports updating their financial material which will be subject to SEC review and comment.

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<sup>13</sup> Under Section 12(g), an issuer that is exempt from the 1934 Act can register its stock with the SEC. Once an issuer submits to the registration and reporting requirements, it can opt to discontinue that status only under very limited circumstances. For practical purposes here, it is a permanent election.

The issue is whether this voluntary filing is sufficient, or whether the GSEs' SEC exemption should be eliminated and the GSEs should be required to fully register their debt, equity and MBS issuances. There appears to be no adverse impact to the housing finance system, nor significant additional burden to the GSEs, of requiring Fannie Mae and Freddie Mac to register either their non-MBS debt or their equity securities under the Securities Act of 1933 and the Exchange Act of 1934. However, MBA believes the statutory exemption for MBS issued by the GSEs should be preserved.

GSE MBS is traded through pools with specified characteristics and through trades of MBS of a generic nature, not yet identified. These generic MBS are traded in the to-be-announced, or TBA, market. The TBA market has numerous uses for the mortgage industry, including dollar roll hedging, without the intent to take control of the actual collateral, reference pricing, purchasing collateral for future structured transactions, and other purposes. One problem with SEC registration for GSE MBS is that TBA securities could not comply with the rigorous disclosure regime required under the SEC's Regulation AB because actual information is not available for these issuances prior to purchase.

A second concern is that there would be significant transaction delays caused by the SEC process. According to 2004 testimony by the SEC, the timing of transactions could be affected.<sup>14</sup>

A third problem with bringing GSE MBS under SEC registration is that the lenders who sell their mortgages in return for MBS could be viewed under the securities laws as underwriters with underwriter liability. All of these factors will converge to make GSE executions more expensive and impede a market which is working very well.

At the same time, it does not appear that investors would gain much by virtue of registration of GSE MBS. Investors already have distinctive safeguards with GSE MBS for several reasons:

- Fannie Mae and Freddie Mac mortgage securities almost always include a *corporate guarantee* that principal and interest will be paid in the manner described and principal will be repaid;
- Fannie Mae and Freddie Mac remain engaged in their transactions in significant roles, including as trustee, master servicer, and guarantor; and
- Fannie Mae and Freddie Mac are responsible under the terms of their agreements to assume servicing responsibilities in the event of a default and to assure that the loans are serviced as agreed.

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<sup>14</sup> See testimony of Alan Beller, Director, SEC Division of Corporate Finance, before the Committee on Bank, Housing and Urban Affairs, United States Senate, February 10, 2004. [www.sec.gov/news/testimony/ts021004alb.htm](http://www.sec.gov/news/testimony/ts021004alb.htm)

## **VI. IMPROVEMENTS TO THE REGULATION OF THE FEDERAL HOME LOAN BANKS**

The FHLBanks have a distinctive structure and an important housing role.

MBA strongly supports the FHLBanks and their advancing, mortgage and affordable housing programs. Several hundred of our member companies are members of FHLBanks and, for many of those institutions, their largest single investment is their stock in their FHLBank. Appropriate regulation of the Federal Home Loan Bank System is critical to our members and to the continued support of housing provided by the FHLBanks. MBA suggests the following be considered in establishing improvements to the regulation and oversight of the FHLBanks.

### **A. Any New Regulatory Structure Should Recognize the Distinctive Nature of the System**

The Federal Home Loan Bank System has a major presence in global capital markets with \$934 billion of consolidated obligations outstanding. The proceeds of those obligations are used to fund the \$641 billion in advances outstanding to member institutions and to fund portfolio investments. The advances are collateralized and the collateral is largely residential mortgage loans. Through their advancing programs, the FHLBanks stimulate demand for mortgage loans and provide funds for them.

In addition to supporting community institutions by providing low-cost advances, the FHLBanks' advancing program supports housing. This support comes from the requirement that advances be collateralized, and almost all of that collateral is residential, single-family mortgage loans.

The FHLBanks, with assets of \$1.02 trillion as of December 31, 2006, support housing in other ways as well. For example, they held over \$100 billion in Fannie Mae, Freddie Mac and non-agency MBS at the end of 2005. The FHLBanks also held approximately \$9 billion in debt of Fannie Mae, Freddie Mac, and state and local housing agencies. Finally, the Banks hold approximately \$98 billion in residential mortgages through their MPP and MPF programs.

The FHLBanks differ from the other two GSEs in many ways, including some of the following major respects:

- **Structure:** Fannie Mae and Freddie Mac are shareholder-owned and publicly traded corporations. The Federal Home Loan Banks comprise a system of 12 institutions, each covering certain states and each cooperatively owned by member institutions in those states.
- **Profit Motivation:** As cooperatively owned institutions, the FHLBanks' primary focus is member service through their programs and, therefore, their businesses are less focused on maximizing profits than the other GSEs.

- **Membership Value:** Members receive dividends from the FHLBanks as well as beneficial advancing rates and the right to participation in the FHLBanks' mortgage purchase and affordable housing programs.
- **Scope of Mission:** The FHLBanks primarily support residential housing but they are also empowered to support economic development, including commercial, industrial, manufacturing, social service, and other projects.

Accordingly, any new regulatory structure should reflect the fact that the FHLBank System is fundamentally different from Fannie Mae and Freddie Mac. Some of the bills introduced in previous Congresses have recognized this distinction to a greater or lesser degree. While MBA supports establishment of a single regulator to oversee Fannie Mae, Freddie Mac and the Federal Home Loan Bank System, a separate division should focus on the FHLBanks.

## **B. Securitization Authority Should Be Made Explicit**

In addition to their advancing programs and the collateral required to be held, the FHLBanks support housing through the billions of dollars they hold as investments in GSE mortgage-backed securities and in residential, single-family mortgages purchased through their Mortgage Purchase Program (MPP) and Mortgage Purchase Finance (MPF) programs. While these programs have shrunk in recent years to approximately \$98 billion, they remain valuable to the mortgage market to a greater extent than their dollar volume might indicate. They provide important competition to the programs of the other GSEs.

The Federal Housing Finance Board has expressed concerns about the FHLBanks holding mortgages on their balance sheets. From a safety and soundness perspective, the primary tool to manage these assets would be securitization of these loans. However, concerns have been expressed that the FHLBanks may not have the authority to do so.

While MBA believes that the Federal Home Loan Bank Act conveys adequate authority in this area, MBA thinks it would be useful to add clarifying language to the statute for this purpose. Securitization would further increase competition in the secondary market benefiting home loan borrowers and renters with lower costs.

## **C. The FHLBanks' Affordable Housing Program Should Be Preserved**

As a result of the FHLBanks' Affordable Housing Program, the Banks collectively are the largest donor organization to affordable housing in the nation. The program functions well, it achieves its purpose and is well administered. Considering that the FHLBanks are doing their share to support affordable housing, MBA does not believe that further intervention, such as attaching goals to eligible collateral or making the FHLBanks subject to other goals is necessary.

## **VII. CONCLUSION**

The Mortgage Bankers Association appreciates the opportunity to present its views on these important issues. MBA will do all it can to help the Congress move forward to develop, and we

hope shortly enact, effective, comprehensive, GSE legislation to provide effective safety and soundness and mission regulation for the GSEs and the FHLBanks.